

## **Entrepreneurship and Small Business in Eastern Europe: Overcoming Challenges, Sustaining Growth**

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### **Abstract:**

Small business entrepreneurship is an indicator of market competitiveness and minimal risk both market and systemic. This paper analyses the political, economic, and societal conditions in seven emerging European economies including Russia (EEE7) - Belarus, Poland, Romania, Russia, Serbia, Slovenia, and Ukraine - in order to assess the state of small and medium-sized enterprises (SMEs) following the onset of the global economic crisis. We identify the specific challenges, both systemic institutional ones and those due to the knock-on effects of the crisis, facing small businesses in these countries. We then draw conclusions about the ability of SMEs to help bring about recovery and sustain the growth of their respective economies and perhaps that of the region as a whole. Implications for the role of entrepreneurial capitalism contributing to the economic growth and market sustainability of small geographically contiguous countries located between larger regions and region states in other parts of the world are discussed.

**Keywords:** Small and medium-sized enterprises (SMEs) | Crisis | Uncertainty | Systemic risk | Market risk | Risk analysis | Market sustainability | Entrepreneurship | Emerging European economies (EEE)

### **Article:**

Entrepreneurial capitalism is the innovative, risk-taking base of a viable economy. Broad and ready market access for risk-taking creates value and sustains markets. The health of a country's small and medium-sized enterprises (SMEs) is a measure of the market sustainability and prospects for future growth of the domestic economy. Micro enterprises and SMEs are socially and economically important (European Commission, 2011). In the European Union (EU), SMEs are those firms with fewer than 250 employees, €50 million sales turnover, and €43 million balance sheets. They provide around 90 million jobs and represent 99 percent of all EU enterprises (European Commission, 2011). In the United States (US) SMEs with fewer than 100 employees account for 99.6 percent of US firms (United States Census, 2008).

The long-term trend has been for an increasing state presence in the market. Some states have not privatized State-Owned Enterprise (SOEs) and have even nationalized private firms. The crisis market environment has accelerated this trend. It therefore is critically important, given the changing set of circumstances accelerated by the global economic crisis, to assess what level of reduced risk that the state provides is necessary for optimal risk-taking, economic growth, and market sustainability.

Firm creation depends on the state's provision of optimal market conditions in particular a stable legal and regulatory environment and capital markets, and efficient business registration procedures (Klapper et al., 2007). Entrepreneurship, firm creation, and private sector development in turn create competitive markets, foster innovation, and sustain economic growth. Indeed, it is even claimed that entrepreneurs shape nations (Boyd, 2008, p.14). In short, entrepreneurial capitalism thrives when barriers to entry for economic and political participation are low. The assumption is that individual initiative is a universal condition that is only evident when it is not inhibited by institutional constraints.

The questions now are does the state foster economic growth, i.e., is it an effective market coordination mechanism (Coase, 1937) or does it increase market imperfections that are best reduced by entrepreneurial private enterprise? Also, what do the effects of the state and its institutions have on other systemic risks, market risk, and the private sector as a whole? We can answer these questions, thanks the tremendous efforts that have been made to provide more timely and detailed data. The amount and variety of data has become so great however, that it requires our own efforts to grasp and relay the extent to which we are now able to better understand conditions in countries throughout the world.

Our focus is on seven distinctive emerging economies in Eastern Europe including Russia (EEE7). These countries are located throughout the region and are of varying size, level of economic development, and regional affiliation.

The research methodology conceptualizes the underlying market or domestic conditions of the Porter Diamond and takes a similar approach to Porter's more recent analytical approach to the assessment of the competitive advantages of nations (Porter, 2008; 7/23/09). This paper introduces a multivariate opportunity risk index (ORI) to systemically analyze market conditions. The ORI is comprised of two categories, institutions that affect systemic risk and sustainability factors that affect market risk. Of the nine ORI sub-indices, five are institutional risk factors – political, macroeconomic, economic policy including balances of payments, inflation risks. The

sustainability risk factors are domestic capital market and physical infrastructure risks, civil society risk, and opportunity risks specific to the business environment.

This paper is organized as follows. First, we assess the political, economic, and societal conditions and the level of market and systemic risk in the EEE7 through ORI analysis. We then assess the effect of institutional and sustainability risk factors on the business sector in these emerging economies. We conclude with how entrepreneurial SMEs can help to bring about the recovery and sustain the growth of their respective economies and regions.

## **1. Regional and local conditions**

The seven eastern European countries are located from Russia in the northeast to Slovenia and Serbia in the southwest and Poland to the west. They span the high income (Slovenia), upper middle (Belarus, Poland, Romania, Russia, Serbia) and lower middle (Ukraine) income groups. Their economies are either transitioning from factor- to efficiency-driven (Ukraine), efficiency-driven (Romania and Serbia), transitioning from efficiency- to innovation-driven (Poland and Russia), or innovation-driven (Slovenia) (World Economic Forum, 2011a).

Russia's economy is the heavyweight of the countries in the EEE7 group. Indeed, Russia is a big emerging market like Brazil, China, and India. Russia's economy accounts for the almost 60 percent of the total economic size of the EEE7. It is over three times larger as the next largest economy, Poland and seven-times larger than the smallest of the EEE7 countries, Slovenia.

The table below indicates the EEE7 share of world GDP as measured by purchasing power parity (PPP) has held at a steady 5-plus percent since the 1990s. This is impressive given the extremely dynamic conditions and tremendous transitions these countries have undergone since the end of the Cold War. Also significant is the rising share of their total GDP to the EU, which has risen from 17 percent in the 1990s to an expected 22 percent after 2010. Clearly, these countries and others like it in the region can contribute to the economic growth of the EU, whose GDP is expected to average under 19 percent between 2010 and 2016. It is important to note that the forecasted decline in the share of EEE7 GDP (PPP) relative to other emerging and developing economies.

The EU regional market draw is big for every EEE7 country. Over 70 percent of European exports were imported into other European countries in 2010 (World Trade Organization, 2011). The EU market accounts for 52.4 percent of the Commonwealth of Independent States (CIS) exports in 2010. Moreover, EU members are required to adopt entire body of EU law, the Community *acquis* or *acquis communautaire*, in order to join the Union. This entails political, legal and regulatory, economic, and increasingly fiscal and social integration in the region. Current EU-Hungary relations capture the essence of this process (Davenport and Than, 2012; Werner, 2012).

**Table 1 Relative GDP and Trade**

Region/Grouping	Share of World Total (%)									Inter- and Intra-regional exports	
	GDP PPP			International Trade							
				Exports			Imports			Europe	CIS
	1990s	2000s	2010-16	1993	2003	2010	1993	2003	2010	2010	
European Union (EU)	26	23	19	37	42	35	35	41	36	71	3
Commonwealth of Independent States (CIS)	4.2	4.1	4.3	2	3	4	1.2	1.7	2.7	52	19
EEE7	5.09	5.02	5.04								
EEE7/(CIS+EU)	17%	18%	22%								
Note:											
Emerging and Developing Economies (E&DEs)	36	41	51								
EEE7/E&DEs	14%	12%	10%								

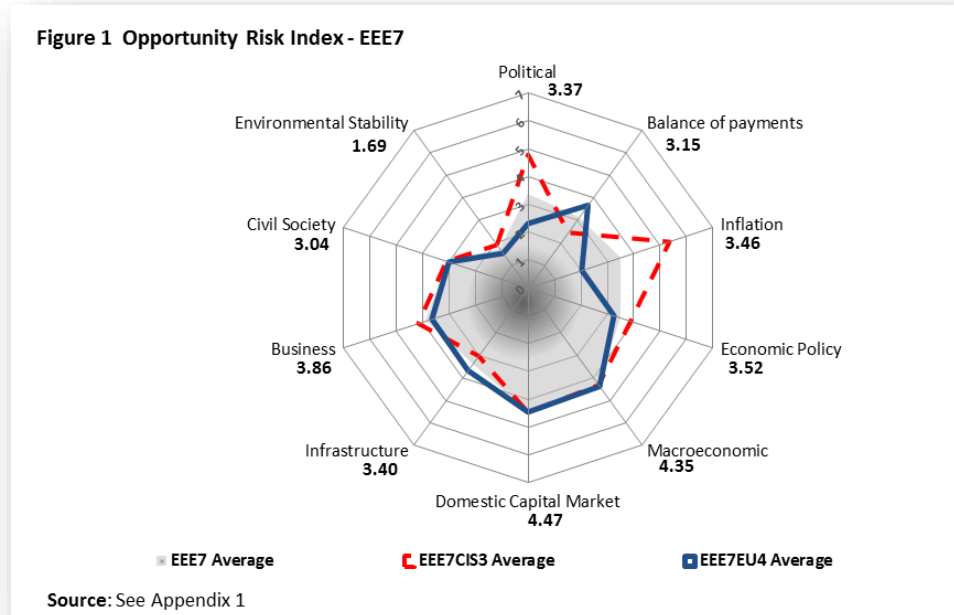
Source: International Monetary Fund, *World Economic Outlook Database*, September 2011; World Trade Organization, "International Trade Statistics," 2011.

The EEE7 countries differ according to regional affiliation. Three of them – Belarus, Russia, and Ukraine – are members of the CIS. The other four – Poland, Romania, Serbia, and Slovenia – are either EU members or an EU “candidate member” (Serbia) (EC, 2012). Economic integration is not high in the CIS. Less than one-fifth of CIS exports in 2010 were imported by other CIS countries. The CIS regional designation is more than a geographic one for several of the member countries. Russia, Belarus, and Kazakhstan entered into a customs union in July 2010. Russia’s Putin had been calling for a full-scale “merger” of Russia and Belarus since 2007 (Wier, 2007; The Telegraph, 2011).

The multivariate opportunity risk indices (ORI) of the EEE7 countries depicted in Figure 1 range between under 3.0 and over 4.20, averaging more than 3.60, just over the 50 percent of a worldwide sample on a base seven scale. Ukraine and Belarus pose the highest overall risk. While Poland and Slovenia pose the lowest overall risk. The radial figures depict the nine risk indices that comprise the ORI. Of the nine risk parameters, the domestic capital markets and macroeconomic structures of the EEE7 countries as group are the most risky. The four EU countries in the EEE7, Poland, Romania, Serbia, and Slovenia, have relatively weak balance of payment positions and limited infrastructure. The three CIS countries in the EEE7 have relatively high levels of political, inflation, economic policy, and business risk. Their respective civil societies present the least risk, as measured in human development terms (e.g., per capita income, income distribution, unemployment levels, access to healthcare, longevity, quality of education, etc.) and near almost identical levels.

The widest ranges of risk among the EEE7 are within the inflation and political sub-indexes. These risk parameters differentiate the EU countries and the CIS countries. In both areas, the EU countries present low risk while the CIS countries present high risk, especially very high inflation risk. Ukraine has extremely high inflation risk and Poland has extremely low inflation risk. In the area of political risk, the Belarusian and Russian political systems are very risky and those of Poland and Slovenia are not. The greatest disparity of risk among the EEE7 is freedom of the press, reserve balances, portfolio investment flows, overall inflation risk, foreign exchange rates, crowding out of private sector credit by public sector borrowing, and taxes on exports. The

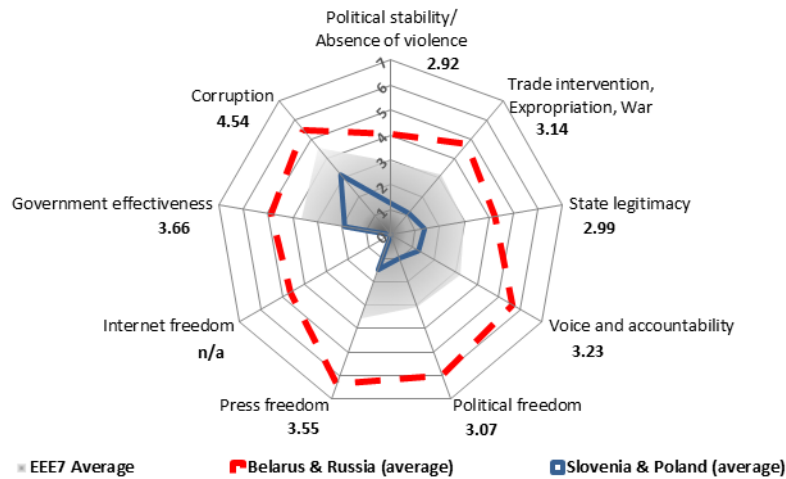
narrowest risk disparities among them is the level of government spending to GDP, access to improved water sources, low public sector borrowing crowding out private sector borrowing, ability to attract incoming FDI (as a percentage of GDP), overall business risk, high literacy rates, and a relatively narrow gender gap.



Each of the seven countries presents a unique combination of risks that comprises the overall attractiveness and sustainability of their market for small business entrepreneurship. Individually and in terms of the multivariate ORI, Ukraine and Serbia present the highest overall risks, followed by Belarus and Russia. Romania presents an average level of risk while Slovenia and Poland are the least risky (See Figure 2).

At the top of the political risk index dial is the risk corruption in all areas of government, the military, education system, as well as in the media and private sector business. Corruption presents the most significant political risk by far in the EEE7 countries. It averages well over 4.50, over 5.00 in the CIS countries and about 3.75 in the EU countries. The most corrupt countries are Ukraine and Russia and the least corrupt are Slovenia and Poland. The World Bank governance indicator, Control of Corruption, ranks the EEE7 countries in a range from Slovenia at the 35th to Russia the 183rd most corrupt of 213 countries. The second corruption measure is compiled by Transparency International (TI) to assess public sector corruption and is based on the multiple surveys. Eight surveys comprise the so-called Corruption Perception Index (CPI) for every EEE7 country in 2011, except Belarus, which relied on three surveys. The most corrupt public sectors, according to the CPI, are the CIS countries, Ukraine with a rank of 152nd and Belarus and Russia tied at 143rd of 183 countries. The World Economic Forum (WEF) reports that respondents to its surveys perceive Ukrainian government policymaking to be among the least transparent in the world, at a rank of 140th of 142 countries (World Economic Forum, 2011a, p. 305).

**Figure 2 Political Risk Index - EEE7**



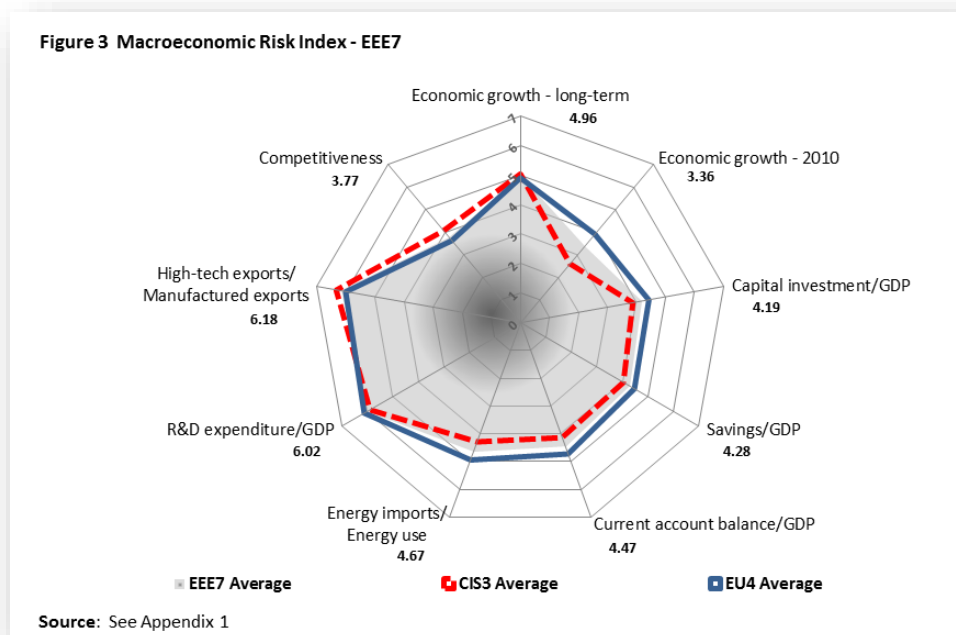
Source: See Appendix 1

The third corruption measure and second TI corruption measure, the Global Corruption Barometer, is a public opinion survey from a home country perspective of the degree of corruption in both the public sector and the business/private sector. According to this measure, Ukraine is the most corrupt EEE7 country, especially its police and judiciary. The EU countries in the EEE7 perceive their political parties to be their most corrupt public institution. In Ukraine it is the judiciary, in Russia it is the police, and in Belarus it is public officials and civil servants that are perceived to be the most corrupt. This is also evident in the CIS countries in Central Asia. Leaders there have used police, the military, intelligence services and the criminal justice system to consolidate their personal rule (Denber, 2012). However, the least corrupt institutions in every EEE7 country are the military and the media. Other freedoms such as political freedoms, the freedom of expression, association, media, and internet freedom are very limited in Belarus and Russia. This is significant because press freedom is so limited there. Freedom House ranks the Belarusian press among the least free in the world, at a rank of 190th of 196 countries. Russia's press is 175th.

The second biggest source of political risk is the ineffectiveness of the EEE7 country governments (World Bank – International Finance Corporation, 2010). The CIS countries, including Ukraine present the most problems. The Belarusian government's policies and ability to serve is people have deteriorated since 1998. Government ineffectiveness also increased between 2004 and 2010 in Romania and Ukraine. Only the governments of Slovenia and Poland are effective. Another source of political risk is the risk of government intervention in international trade and investment transactions, expropriating assets, and even going to war. The risk of the Belarusian government interrupting international trade and investment are at the highest level (Belgian Export Credit Agency, 2011).

**Macroeconomic Risk** The risk posed by the structures of the economies of the EEE7 countries is consistently elevated. Macroeconomic conditions have improved in the economies of the EEE7 countries since the 1990s, but not as much as they could have. Only Russia's consistent long-term growth rates, energy exports, mineral-driven current account surpluses, and transition to an innovation-driven economy make its macro-economy less risky. The most significant macroeconomic risk factor in Russia and the rest of the EEE7 is the absence of technology, as indicated by the low high-tech exports and R&D expenditures.

Another important source of macroeconomic risk is energy dependence. Every EEE7 country, except Russia, imported over 40 percent of the energy it consumed in 2009. Russia exported an extra 80 percent of its energy consumption in 2009. The rents Russia derived from its resource endowments and earnings from its energy exports have contributed to 33 percent of Russia's GDP growth in the 2000s. Belarus and Ukraine, across which Russia has long had in place its pipelines to Europe, are together with Slovenia, the most energy dependent countries in the EEE7. Having to import 85 percent of its energy consumption, makes Belarus one of the most energy dependent countries in the world, an irony given its neighbor and potential "merger partner" is Russia. Poland's energy dependence has also substantially increased throughout the period. Energy imports accounted for less than three percent of the country's energy consumption in the 1990s, over 17 percent in the 2000s, and almost 29 percent in 2009. Serbia has also experienced a significant increase in energy dependence.

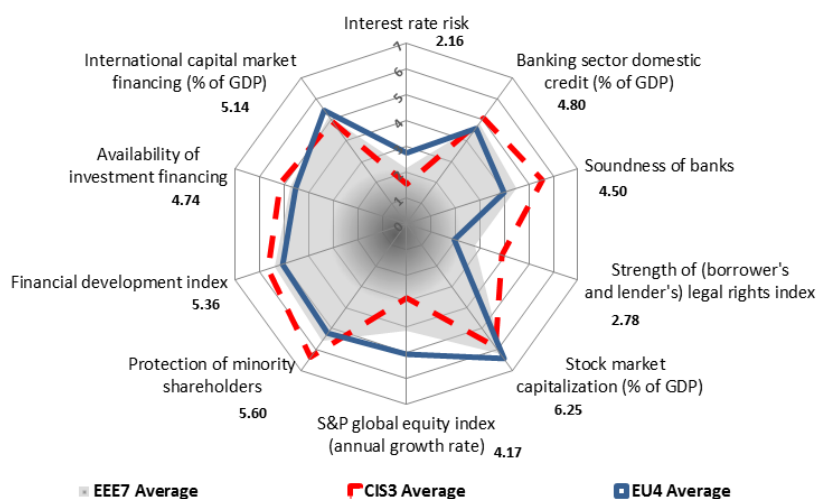


The interconnected variables of the share of savings, investment, and current account balance to GDP pose the next most significant macroeconomic risks. The current account balance and underlying savings investment identity are either hover around zero or are negative. Only Russia enjoys a favorable set of macroeconomic conditions in this regard. Its current account surplus more than adequately compensates for a low domestic investment (i.e., gross fixed capital

formation) rate. Low savings and investment rates and rising current account deficits are bigger problems for the four EU countries in the EEE7, Poland, Romania, Serbia, and Slovenia. The lowest source of macroeconomic risk in the EEE7 is their international competitiveness, as assessed in the WEF Global Competitiveness Index.

**Domestic Capital Market Risk** An efficient, stable, and credit risk-taking banking system, a sustainable distribution between public and private debt financing, the availability of equity financing, investor interest, and legal and regulatory frameworks to support them are components of a viable domestic capital market infrastructure. The domestic capital markets of the EEE7 countries are not well developed. The average domestic capital risk index value is 4.45. Poland's capital market is more developed than are those in the other six countries. Access to financing (i.e., loans, equity, and venture capital) averages 4.74, more in the CIS countries of the EEE7, especially Ukraine, (data for Belarus is not available) and less in the EU countries, especially Poland. The WEF Financial Development Index, which includes an assessment the financial development of every EEE7 country except Belarus, Serbia, and Slovenia, is lower.

Figure 4 Domestic Capital Market Risk Index - EEE7



Source: See Appendix 1

EEE7 equity markets are especially underdeveloped. Indeed they are among the least developed in the world. The underlying regulatory of minority shareholder protection is not in place and is among the weakest worldwide. The annual percent change of their respective S&P equity indices and the ease of financing in their local equity market is less risky (World Economic Forum, 2011a; World Bank, 2011a). Indeed, the WEF's Executive Opinion Survey results suggest local equity financing is easier than getting a loan in local debt markets (World Economic Forum, 2011a). EEE7 equity markets are also particularly vulnerable to global portfolio equity market volatility. Of the five EEE7 countries reporting S&P equity index data to the World Bank, Slovenia and Ukraine's equity markets were among the best performing in 2007. During the crisis in 2008, however, EEE7 S&P global equity indices declined the most in the 1990-2010 period. Ukraine's stock market contracted by 82 percent, the steepest decline among the countries 69 countries reported. Russia, Romania, and Slovenia along with Ukraine were among



the eight countries that experienced the steepest stock market valuation drops. Russia's equity market dramatically rebounded in 2009, with its S&P equity index growing by 107 percent. Stock market valuations in the other EEE7 countries also grew in 2009 but more modestly, from 16 percent (Slovenia) to 42 percent (Poland).

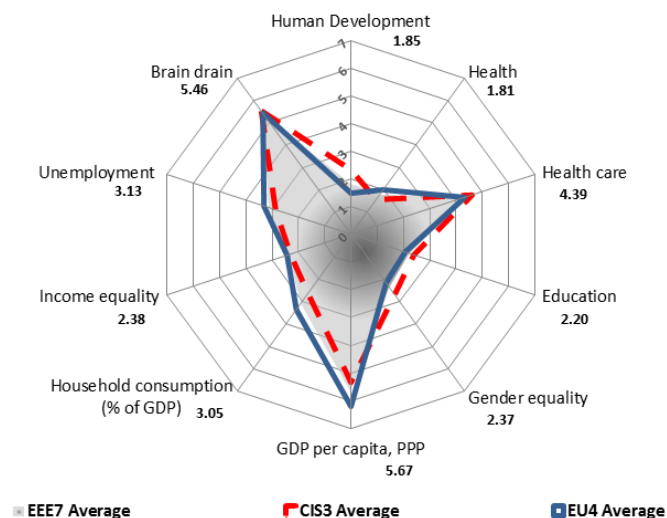
EEE7 debt markets are more viable than their equity markets. Interest rate spreads are narrow across the board and the legal rights index is strong. Ukraine's strength of legal index, as is Poland and Romania's, were a remarkably high. The soundness of the banking system and the credit provided by it as a share total domestic credit is not high. Only Poland's banks are more sound than the global average but they do not provide a proportionately high share of domestic credit. Ukraine's banking system ranked among the weakest, between Iceland and Poland in 2001 (World Economic Forum, 2011a, p.305). Slovenia and Russia's banking system is the weakest, (World Economic Forum, 2011a, pp.305, 321).

**Civil Society Risk** Political and economic systems rest on their civil societies. The civil society risk index therefore rounds out the opportunity risk index. It yields some of most important indicators of potential business opportunities in the EEE7 countries. The fact that this facet of the opportunity risk index is the lowest suggests ample sources of optimal market conditions. The health, education, and overall all human development is very good. The United Nations human development index (HDI), which measures standard of living by qualitative indicators such as education, health care, life expectancy, etc. is either "high" or very "high" (United Nations Development Programme, 2010). Infant mortality has been significantly reduced since 1990. Average life expectancy declined from 70 years in 1990 and 69.4 years in 2009 in the three CIS countries, while it jumped from 71.4 years to over 75.5 years in the four EU countries. Adult and youth literacy is nearly universal. Mean years of schooling have increased and the quality and quantity of higher education and training is well above the global average (United Nations Conference on Trade and Development, 2011; United Nations Development Programme, 2010; World Economic Forum, 2011b). The quantity, as well as quality, of education is one of the biggest contributors to the international competitiveness of EEE7 countries.

The most significant civil society risks in every EEE7 country are low per capita income (PPP) and high rates of emigration, as measured by the "brain drain" of some of the society's most highly skilled and motivated citizens. The population of the EEE7 countries declined by over five percent, from about 281 million people in 1990 to 266 million in 2010. Only Slovenia's population grew. Every EEE7 country ranks among those countries experiencing the greatest loss of skilled labor. Serbia, Romania, and Ukraine are near the "top" the WEF list of 142 countries with an average rank of 132nd. Another significant civil society risk factor is the provision of health care services, especially in Romania, Poland, and Serbia.

**To conclusion?** No country better exemplifies the interdependence of the risk variables than Ukraine. Ukraine continues to straddle the CIS-EU region, a position that does not appear to have become easier over time.

Figure 5 Civil Society Risk Index - EEE7



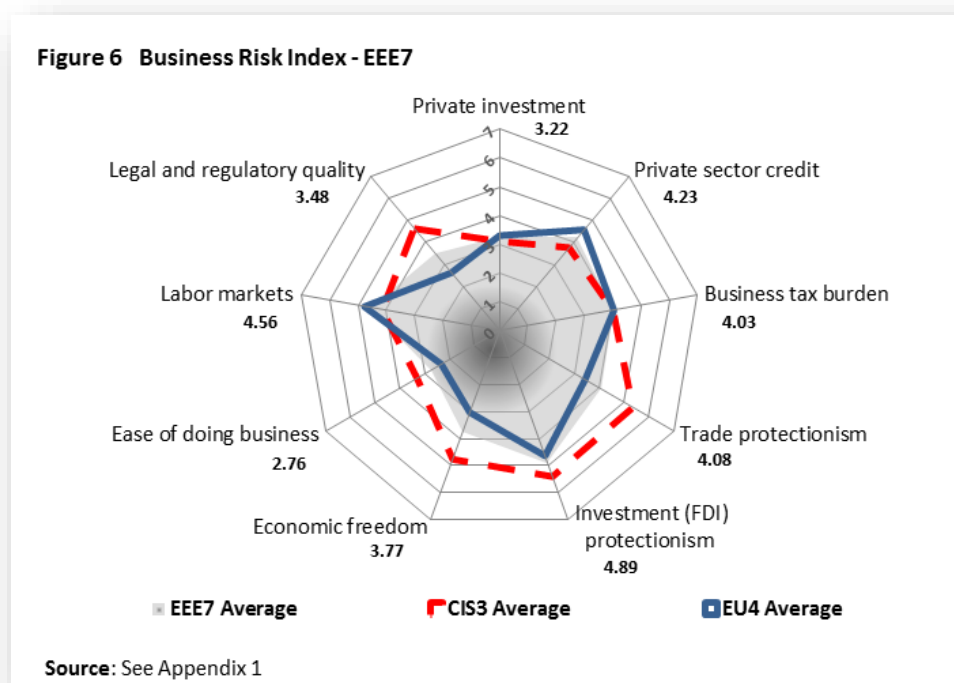
Source: See Appendix 1

## 2. EEE7 business risk: Implications for small business management

The World Bank's "Ease of Doing Business" index indicates doing business in the EEE7 countries is comparatively easy. The Doing Business variables also pose the lowest risk (2.76) in the business risk index listed below. Business conditions have improved in number of areas, such as the time and number of procedures required to start a business. Here the government's regulatory burden, especially in Belarus, has been lightened. The number of days required to start a business dropped by 20 days, from an average in the 2000's of 35 days, to 15 days in 2010, and 18 days in 2011. The biggest decline was by 51 days for Belarusian start-ups. While other "Doing Business" variables have also improved onerous burdens on business remain. Preparing and paying taxes, while becoming less costly and time consuming, are still significant business expenses in all EEE7 countries, especially in the CIS countries. Slovenia is among "easiest" places to do business in the world the ease of doing business is low in CIS countries, especially in Ukraine and Russia.

Net FDI inflows into the four EU countries of the EEE7 sharply contracted from 4.4 percent of their GDP in the 2000s to just 2.1 percent in 2010 (World Bank, 2011a). The opposite trend is evident in three CIS countries. Yet the government of every EEE7 country discourages FDI from abroad (World Economic Forum, 2011a, p. 463). The WEF does not include Belarus in its sample. Outgoing FDI is almost equally limited, except from Russia and Poland (World Bank, 2011a). FDI outflows as percent of GDP sharply contracted sharply from Slovenia between 2009 and 2010. This was part of a global trend, among high-income countries in particular, of FDI outflows peaking at an average 4.59 percent of GDP in 2007 and declining thereafter until 2010 (World Bank, 2011a). But no other EEE7 was part of it. Foreign ownership of companies is generally limited, but especially in Ukraine, Slovenia, and Russia (World Economic Forum, 2011a, p.462). These risks give rise to risks such as limited technology transfer from abroad through FDI (World Economic Forum, 2011a, p.492). Only Poland benefits from technology embedded in FDI. Two other possible negative side-effects of limited foreign presence in EEE7

markets are overall lower firm-level technology absorption and the loss of the potentially positive effect FDI and foreign firms may have on how businesses are managed (World Economic Forum, 2011a, p. 491). Labor-employer relations in EEE7 markets are contentious (World Economic Forum, 2011a, pp. 305, 307, 321). Hiring and firing practices in Slovenia's labor markets are the worst of the WEF countries surveyed (World Economic Forum, 2011a, p.321).



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Business Penetration and Competition: Access to Investment Financing							
	GCI Benchmark (Rank)	Rank (142 countries)				Share of 2010 GDP (%)	
		Ease of access to loans	Financing through local equity markets	Venture capital availability	Average	Gross fixed capital formation, private sector	Domestic credit to private sector
Poland	41	71	55	79	68	n/a	54.8
Slovenia	57	107	108	84	100	n/a	94.4
Russia	66	91	98	88	92	19.1	45.1
Romania	77	82	89	77	83	28.2	46.1
Ukraine	82	128	123	114	122	17.7	61.7
Serbia	95	97	112	121	110	19.2	51.5
Belarus	n/a	n/a	n/a	n/a	n/a	34.6	44.8

Sources: WEF, 2011a; World Bank, 12/15/11.

The third biggest business risk factor is the private sector's limited access to credit. This is to be expected because the EEE7 domestic capital markets are so undeveloped that it is riskiest parameter in the entire ORI. Only Slovenia's private sector share of domestic credit is high. Another access to credit variable, the ratio of public and private borrowing from abroad, assesses the degree to which private sector borrowing (i.e., private non-guaranteed (PNG) loans) is being "crowding out" the state and public borrowing (i.e., public and publicly guaranteed loans) in international capital markets. The PPG:PNG ratio, is based a sample of just over 50 countries and includes only four of the seven EEE7 countries Belarus, Romania, Russia, and Ukraine. What the long- and short-term "crowding out" variables suggest is that the rate of public sector borrowing abroad was a minimal source of business risk until the global economic crisis in 2008. The ratio subsequently jumped between 2009 and 2010 and "crowding out" appears to have become a significant source of business risk in Ukraine, Romania, and Belarus.

Private capital investment. This was not a significant risk factor in 2010. The following table takes a closer look at the effect limited access to private investment financing has on EEE7 business. Access to debt, equity, and venture capital financing is uniformly limited. The data in the table indicates limited financing and poses the greatest risk to doing business in Ukraine. It poses significant risks in Serbia, Slovenia, and Russia, with the least risk in Poland and Romania.

The high private sector share of domestic credit notwithstanding, WEF survey respondents site access to financing as the most problematic factor for doing business in Slovenia (World Economic Forum, 2011a, p. 320). This is a recent turn of events. Slovenian banks issued credit quickly throughout the 1990-2010 period, especially after 2003. Domestic credit provided by the banking sector jumped from an average 33 percent of Slovenia's GDP in the 1990s to 56 percent in the 2000s, and jumped again to 97 percent by 2010. The private sector share of domestic credit also increased, from an average 27 percent of GDP in the 1990s, to 50 percent in the 2000s, to reach 94 percent of GDP in 2010 (World Bank, 2011a).

The availability of venture capital, a component of the availability investment financing risk parameter in domestic capital markets, is uniformly limited. Venture capital is the scarcest source of investment financing in every EEE7 country except Romania and Slovenia. It is a significant detractor from every EEE7 country's except Romania international competitiveness. Access to venture capital is also critical to SME viability. Among the EEE7, EU country (Poland, Romania, and Slovenia) private equity investments, investment in seed and start-up enterprise investment are almost non-existent, and much less than the greater than 50 percent share in Baltic countries (Estonia, Latvia, and Lithuania) and the EU average share of 4.8 percent (European Commission, 2010). Here we see the coincidence of political and economic participation. The former Soviet republics in the Baltic swept aside Soviet era political elites and have created more space for new political actors who built strong institutions, instituting checks and balances, and implementing legislative reforms prioritizing due process and human rights protection (Denber, 2012, pp.31-32).

Trade protectionism is the fourth most significant risk factor for business in the EEE7 countries. The World Economic Forum's 2010 "Global Enabling Trade Index" suggests a general trend of rising trade protectionism in every EEE7 country for which data one 125 countries was reported after the global economic crisis. Trade protectionism in Ukraine increased the most and remained unchanged in Romania. Trade protectionism in Russia is very high.

The governments of the EEE7 countries levied, on average, a 14 percent tax on industry and services value-added in 2009, a 46 percent tax rate on commercial profits in 2011, and taxes on exports accounted for 21 percent of tax revenue of the CIS countries in 2009 (EU countries did not report this data) (World Bank, 2011a). A whopping 41 percent, the highest rate in the world, of the Russian government's tax revenue in 2009 was from export taxes. The commercial profit tax rate was even higher in the other two CIS countries, Belarus and Ukraine, at around 60 percent. In this regard, it bears repeating that with an average rank of 122nd of 142 countries the WEF Global Competitiveness Report cites the "extent and effect of taxation" as the most problematic factors for doing business in every EEE7 country (World Economic Forum, 2011a, p. 455). This risk factor is present in many countries throughout Europe, Eastern Europe, the Balkans, Baltic, and Scandinavian countries. Tax burdens in the EEE7 are so heavy they reduce the incentive to work and invest.

An apparently insignificant risk of doing business in the EEE7 countries is the quality of the legal and regulatory framework, including the rule of law and the strength of investor protection. The regulatory quality and the rule of law parameters affect the entire private sector but are included in the business risk index to temper the strength of investor protection index. In general, investor protection is stronger and therefore presents less risk than do the rule of law and regulatory quality governance. On average, none of these governance factors elevate business risk. The only significant departure, in terms of contributory risk, is the rule of law and regulatory quality in the CIS countries, Belarus in particular. If we take a closer look at the government regulation of business, it is extremely burdensome. The table below indicates the extent and effect of taxation on business is widespread in the EEE7 (See Table 3).

#### **Added protection of minority shareholders' rights**

Table 3

	GCI Benchmark (Rank)	Regulatory burden	Regulatory efficacy					Average
			Investor protection	Anti-monopoly policy	Property right protection	Efficacy of dispute settlement mechanisms	Extent and effect of taxation	
Poland	41	124	36	49	57	97	107	69
Slovenia	57	94	20	52	53	111	129	73
Russia	66	132	77	111	130	123	106	109
Romania	77	105	36	93	90	122	135	95
Ukraine	82	130	93	136	134	138	141	128
Serbia	95	134	60	137	123	137	118	115
Belarus	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: WEF, 2011a.

Table 3 Regulatory Effect on Global Competitiveness										N = 142 countries
	GCI Benchmark (rank)	Burden of government regulation (rank)	Regulatory efficacy (rank)							Average
			Protection of:				Efficacy of:		Extent and effect of:	
			Investors	Minority shareholders' interests	Anti-monopoly policy	Property rights	Dispute settlement mechanisms	Taxation		
Poland	41	124	36	79	49	57	97	107	71	
Slovenia	57	94	20	127	52	53	111	129	82	
Russia	66	132	77	135	111	130	123	106	114	
Romania	77	105	36	98	93	90	122	135	96	
Ukraine	82	130	93	138	136	134	138	141	130	
Serbia	95	134	60	140	137	123	137	141	123	
Belarus	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Average rank	70	120	54	120	96	98	121	127	103	

Source: World Economic Forum, Global Competitiveness Index (GCI), 2011-12.

Regulatory inefficacy also appears to accompany a high regulatory burden. Equally ineffective are dispute settlement mechanisms. Limited property right and anti-monopoly policy protections are also ineffective, especially in Serbia, Ukraine, and Russia. A relatively strong legal rights index for lenders and borrowers in the EEE7 country debt markets contradicts what appear to be otherwise weak legal and regulatory systems, in particular the limited protection of minority shareholders in equity markets. This is an example of limited property right protections. Only investor protection is effectively regulated.

In addition to the private sector share of domestic capital investment and access to credit, the degree of industrial concentration and the level of foreign competition give us a good idea of how business penetration and efficacy affect SMEs (See Table 4).

Business Penetration and Competition: Market Structure						
	GCI Benchmark (Rank)	Rank (142 countries)				
		Accountability of private institutions	Intensity of local competition	Extent of local market dominance	Prevalence of foreign ownership	Average
Poland	41	52	38	36	85	53
Slovenia	57	71	51	63	126	80
Russia	66	128	124	101	129	118
Romania	77	81	97	74	84	85
Ukraine	82	132	120	129	116	122
Serbia	95	130	136	139	116	130
Belarus	n/a	n/a	n/a	n/a	n/a	n/a

Sources: WEF, 2011a; World Bank, 12/15/11.

Table 4

Table 4 Business Penetration and Competition: Market structure						
	GCI Benchmark (Rank)	Rank (142 countries)				
		Accountability of private institutions	Intensity of local competition	Extent of local market dominance	Prevalence of foreign ownership	Average
Poland	41	52	38	36	85	53
Slovenia	57	71	51	63	126	78
Russia	66	128	124	101	129	121
Romania	77	81	97	74	84	84
Ukraine	82	132	120	129	122	126
Serbia	95	130	136	139	116	130
Belarus	n/a	n/a	n/a	n/a	n/a	n/a
Average rank	70	99	94	90	110	99

Source: World Economic Forum, Global Competitiveness Index (GCI), 2011-12.

The elevated business risk of FDI protectionism and the consequent low level of foreign ownership affects the structure of EEE7 markets. The Heritage Foundation's 2011 assessment of economic freedom in 183 countries describes none of the EEE7 economies as being "free" (Heritage Foundation, 2011). In fact the three CIS countries in the EEE7 are among the most "repressed" in the world: Belarus, Ukraine, and Russia. Romania, Slovenia, and Poland, while becoming freer are only "moderately free," and Serbia like Russia's is "mostly unfree."

The Serbian economy is among the most concentrated, in terms of limited local competition and market dominance by a few firms. Corporate governance, as measured by the effectiveness of anti-monopoly policy, is limited. Labor-employer relations are poor. Overall domestic capital

investment is very low, which reflects low investment in R&D and firm-level absorption of new technology. Domestic market conditions such as these have hindered the competitiveness of Serbian firms in international markets (World Economic Forum, 2011a, p. 315).

Business risks are high the CIS countries are easily the highest in the EEE7. Corruption is also cited by WEF executive opinion survey respondents as being the most problematic factor for doing business in Russia and Ukraine but especially in Russia (World Economic Forum, 2011a, pp. 306, 356). Russia is also the only country in the EEE7 where business has significant costs of crime and violence (World Economic Forum, 2011a, p. 307). And, while Russia's stock market is the most capitalized among the EEE7, two state-controlled companies, Sberbank and Gazprom, account for more than half of the turnover of the Russian stock exchange (The Economist, 2012).

### **3. Conclusion**

Multivariate risk analysis presents a complex and sometimes less than positive picture for business, especially for SMEs. While the risk variables listed above are numerous and require further analysis, there are positive signs in every EEE7 country. Slovenia's political stability, innovativeness, and competitive markets notwithstanding, limited access to financing, weak banking system, balance of payments pressures, limited contract enforcement, high taxes, and recent spate of reported corruption imply barriers to entry may have increased for smaller firms. It is difficult to assess the extent to which barriers to entry have risen. Poland's otherwise competitive markets continue to grapple with significant regulatory burdens contentious labor markets, and macroeconomic risks, such as energy dependency, and very limited hi-tech markets. Romania's apparent critical lack of transparent governance, public trust of politicians, and domestic capital market and physical infrastructure, high taxes, and contentious labor markets do not appear to overly limit business enterprises including SMEs. Russia's elevated political risk, limited domestic capital market infrastructure, oligopolistic markets, and limited freedoms severely limit entrepreneurial enterprises there. Ukraine's very high inflation risks and elevated political and economic risks may trump more positive indicators of an apparently healthy balance of payments position, adequate infrastructure, and a dynamic civil society. The situation there is fluid. Serbia's elevated macroeconomic risks, concentrated business sector, and high emigration rates balanced by low political risk indicate the country is in the process of transition, which may present opportunities for small business entrepreneurship. The sharp decline of real income in Belarus indicates a severe crisis in the country's civil society (Institute for Privatization Management Research Center, 2011). The political risks of bad governance, chronic public sector corruption, the probability of trade interventionism, expropriation and war, not to mention the political repression evident in extremely limited political, press, and internet freedoms are to blame.

In Europe, where human development is high, a well-educated citizenry inhibited by limited freedoms, burdensome bureaucracies, and inequitable markets, presents a striking paradox, one of low sustainability risks and therefore great market potential and high institutional risks, especially macroeconomic risk. The civil societies in the EEE7 countries are among the most politically savvy, risk-taking, and technically capable in the world. While a dynamic civil society



is present, it appears to devote more of its efforts to coping with institutional constraints, leaving it less time to devote to market competition and improving their standard of living.

Unsustainable domestic capital markets present the biggest risk to business, especially SMEs. They are also indicative of other institutional factors that limit market access. Access to financing would allow for much needed investment in technology. This can have positive effects in the region, especially if these SMEs grow enough to expand overseas, usually beginning in the near abroad of a neighbouring country.

While conditions for entrepreneurial small businesses are not optimal in the EEE7 countries, this assessment is intended to give the decision maker as complete a picture as possible of the risk environment. Some of these complex and higher risks are the very ones that certain businesses seek to undertake as an opportunity. It is after all the job of small business entrepreneurs to take the risks that make things happen, which in turn increases future certainty. Indeed, some businesses are better able to deal with certain. Other risks may be indirect and have knock-on effects both positive and negative, affecting different businesses in different ways. Some risks, however, are to be avoided under any circumstance. These distinctions are best left to the strategic manager.

While conditions for entrepreneurial small businesses are not optimal in the EEE7 countries, this assessment is intended to give the decision maker as complete a picture as possible of the risk environment. Some of these complex and higher risks are the very ones that certain businesses seek to undertake as an opportunity. It is after all the job of small business entrepreneurs to take the risks that make things happen, which in turn increases future certainty. Indeed, some businesses are better able to deal with certain. Other risks may be indirect and have knock-on effects both positive and negative, affecting different businesses in different ways. Some risks, however, are to be avoided under any circumstance. These distinctions are best left to the strategic manager.

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